Part I: National Budget Simulation

Introduction:

The new President of the United States has been elected on the promise of fiscal responsibility. He has promised the voters he will not raise taxes, and he will not reduce Social Security or Medicare. He has promised interest groups that he will not reduce Commerce Department spending. By law he cannot reduce the net interest paid on the debt. The President's budget is projected to leave the country with a $230 billion surplus, and he promises not to allow a deficit, unless the U.S. faces a recession or war.

Suddenly, the United States is subject to military attack -- a turn of events not anticipated in the current budget. At the same time, a lingering recession reduces the government's tax revenues and forces the government to increase its spending on unemployment benefits, welfare, housing assistance, food stamps, and other need-based programs. Because of the increased spending and reduced revenues, the nation falls into a projected deficit of nearly $185 billion.

Then Congress passes legislation to increase military spending by 20 percent, to pay for increased security within the U.S. and to pay for a prolonged military response against the attacking country and other potential threats. The President signs this bill into law, increasing the projected deficit to nearly $254 billion.

The President is committed to keeping his campaign promises, in order to maintain support for his reelection. He must protect the programs he promised to protect, and he cannot raise taxes, so he must cut spending on other programs to stay within his new guideline to keep the deficit below $150 billion. The President turns to you, his trusted economic advisor, for help. (Note: While some events in this scenario reflect actual events, others are hypothetical for the purposes of this exercise. Budget figures are actual White House projections of 2002 spending and revenues as of September 2002).

Process:

1. Follow this link to the [NCEE National Budget Simulation](http://www.econedlink.org/lessons/em306/popupActivity.html).

<http://www.econedlink.org/national-budget-simulator.php>

2. To represent the 20 percent increase in military spending, the spending levels have automatically been changed. You can see how this affects the total spending at the bottom of the column.

3. Scroll to the bottom of the page to see the effect of the increase in military spending on the "New Surplus" (a negative surplus is a deficit). Remember that you need to get this figure below $150 billion. Make note of the relative amounts of the budget spent on each area listed in the table, so that you can decide where cuts might be effective to reduce the deficit.

4. Now begin cutting the program budgets as a tradeoff for the increased defense spending. Remember, for political reasons or by law, you cannot make any changes in these areas: Commerce and housing credit, Medicare, Social Security, Net interest, Allowances, and Undistributed offsetting receipts. You can click on the names of the spending areas to see the programs in the respective spending areas.

5. Keep cutting programs until you have reached your $150 billion deficit limit. Hint: You will have to cut most programs by at least 10 percent to reach your target. When cutting programs, keep in mind that program cuts could seriously affect citizens’ daily lives. Also keep in mind people who may be so angered by program cuts that they will take action to prevent the President’s reelection.

Note:

You may be tempted to quickly reach deficit limits by making extreme cuts or even eliminating entire programs. You should consider the real-life ramifications of such cuts, and realize that even 10 percent cuts in many programs will have serious consequences.

Conclusion:

When you have reached your target, print out your results. Consider which programs you have cut, to help you answer the reflection questions on the following worksheet which will be the basis of your reflection. Be sure to write an explanation of the decisions that you made and the justifications for those decisions

For your reflection consider the following questions as a guide when writing your paragraphs. Your reflection should be word processed and should be between 600-850 words.

How will the program cuts that you made affect specific groups (the elderly, students, environmentalists, savers, the poor, foreign aid recipients, producers, etc.)? What programs did you choose to cut? Why did you choose those programs over others? (5)

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Would other cuts have had less impact on people’s lives? Which budget cuts had the largest impact on reducing the deficit? (5)

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Which decisions might be perceived as politically motivated? (5)

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What are the tradeoffs of preserving some programs while protecting others? (5)

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If you had the opportunity to raise taxes rather than cut programs, which policy would you choose? (5)

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Part II

Answer the following questions using the data below. You may choose to use graph paper and/or a spreadsheet program (e.g. EXCEL) if you prefer.

All quantities are in millions.

|  |  |  |
| --- | --- | --- |
|  | **Hamburgers** | **Houses** |
| **Point A** | 100 | 0 |
| **B** | 80 | 16 |
| **C** | 60 | 24 |
| **D** | 40 | 31 |
| **E** | 20 | 36 |
| **F** | 0 | 40 |

a. Graph the production possibility curve above. (2)  
b. Calculate the opportunity cost of producing the second 20 million hamburgers. (Show your work.) (2)  
c. Calculate the opportunity cost of producing the last 20 million hamburgers. (Show your work.) (2)  
d. Does this economy exhibit constant or increasing opportunity cost? How do you know? (4)

Part III

On a separate page, answer the following questions using the data below. You may choose to use graph paper and/or a spreadsheet program (e.g. EXCEL) if you prefer. Beer is measured in millions of bottles and pizza is measured in thousands of tons.

|  |  |  |
| --- | --- | --- |
|  | **BEER** | **PIZZA** |
| **POINT A** | 30 | 0 |
| **B** | 24 | 2 |
| **C** | 18 | 4 |
| **D** | 12 | 6 |
| **E** | 6 | 8 |
| **F** | 0 | 10 |

a. Graph the production possibility curve above. (2)

b. Calculate the opportunity cost of producing one thousand tons of pizza. Show your work. (2)

c. Calculate the opportunity cost of producing one million bottles of beer. Show your work. (2)

d. Suppose the economy above produced 15 million bottles of beers and 4 thousand tons of pizzas. Graph this point on your graph in a. above. Label it Point G. Characterize this Point: Does Point G represent an efficient, an inefficient, or an unattainable level of production. (4)